RESIDENTIAL RESEARCH

LONDON RESIDENTIAL REVIEW

SPRING 2018

A FRAGMENTED RECOVERY IN THE SALES MARKET

RENTAL VALUES STRENGTHEN

RISING RATES AND BREXIT

KEY FINDINGS

5

Years since there has been a double-digit price movement in either direction in PCL

9%

Rise in the number of transactions between £5 million and £10 million in Q4 2017 versus Q4 2016

26

The number of £5 million-plus transactions in Chelsea in 2017, up from 20 in 2016

1%

Rise in transaction volumes in PCL in 2017 versus 2016

PRIME LONDON SALES MARKET INSIGHT

Though market performance has become more fragmented, some key trends are still discernible, says Tom Bill

By the standards of the last four decades, pricing movements in the prime London property market have become less extreme.

Prime central London (PCL) has not experienced a double-digit price movement up or down for more than five years, which is the longest run since records began in 1976. Meanwhile, the prime outer London index has not moved more than 5% in either direction for almost three years.

As sales volumes and pricing stabilise after a succession of tax changes, market performance has become more nuanced and fragmented.

For example, the number of transactions in PCL between £1 million and £2 million fell 13% in the final quarter of 2017 while there was a 9% rise between £5 million and £10 million, LonRes data shows.

This marks a reversal of an earlier trend following the introduction of higher rates of stamp duty in December 2014.

The turnaround suggests higher transaction costs have become more fully assimilated in higher price brackets after an initially steeper decline in trading volumes.

Meanwhile, overall transaction numbers rose 1% in prime central London in 2017 compared to 2016, LonRes data shows.

The changed tax landscape has had a similar effect on price growth, as Figure 1 shows. While the £5 million to £10 million price band experienced the largest annual price declines between October 2015 and February 2017, it accounted for the strongest growth between June 2017 and January 2018.

The differentiation in performance between separate areas has also grown in the three years since the stamp duty hike in December 2014.

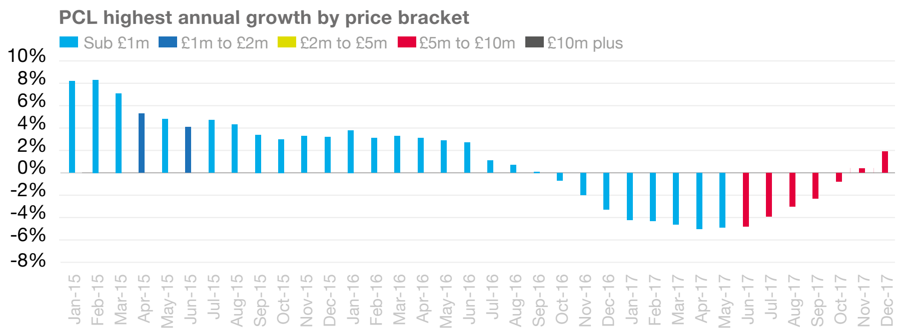
For example, the total number of transactions above £5 million in Chelsea rose to 26 in 2017 from 20 in the previous year, an analysis of LonRes and Knight Frank data shows. The market initially experienced larger price drops than others following the higher stamp duty rates.

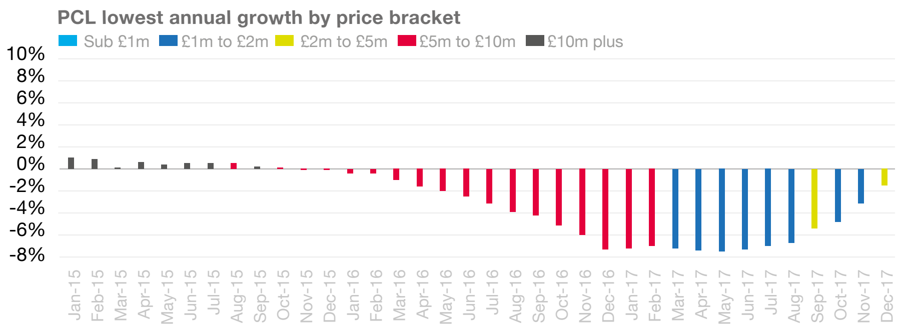
Elsewhere, pricing in Queen's Park has started to decline. Average values rose on an annual basis during the first six months of 2017, but by the end of the year, prices were down 8.7% as stamp duty-related price adjustments rippled out from PCL.

Meanwhile, lower asking prices have underpinned sales volumes in the Fulham house market more than the flat market. There was a 24% year-on-year fall in transactions below £1.5 million (the price point below which most properties are flats) in the first nine months of 2017 compared to a more modest 9.3% decrease above that price point, Land Registry data shows.

FIGURE 1

Reversal of Fortune How the £5m to £10m price bracket became the strongest performer





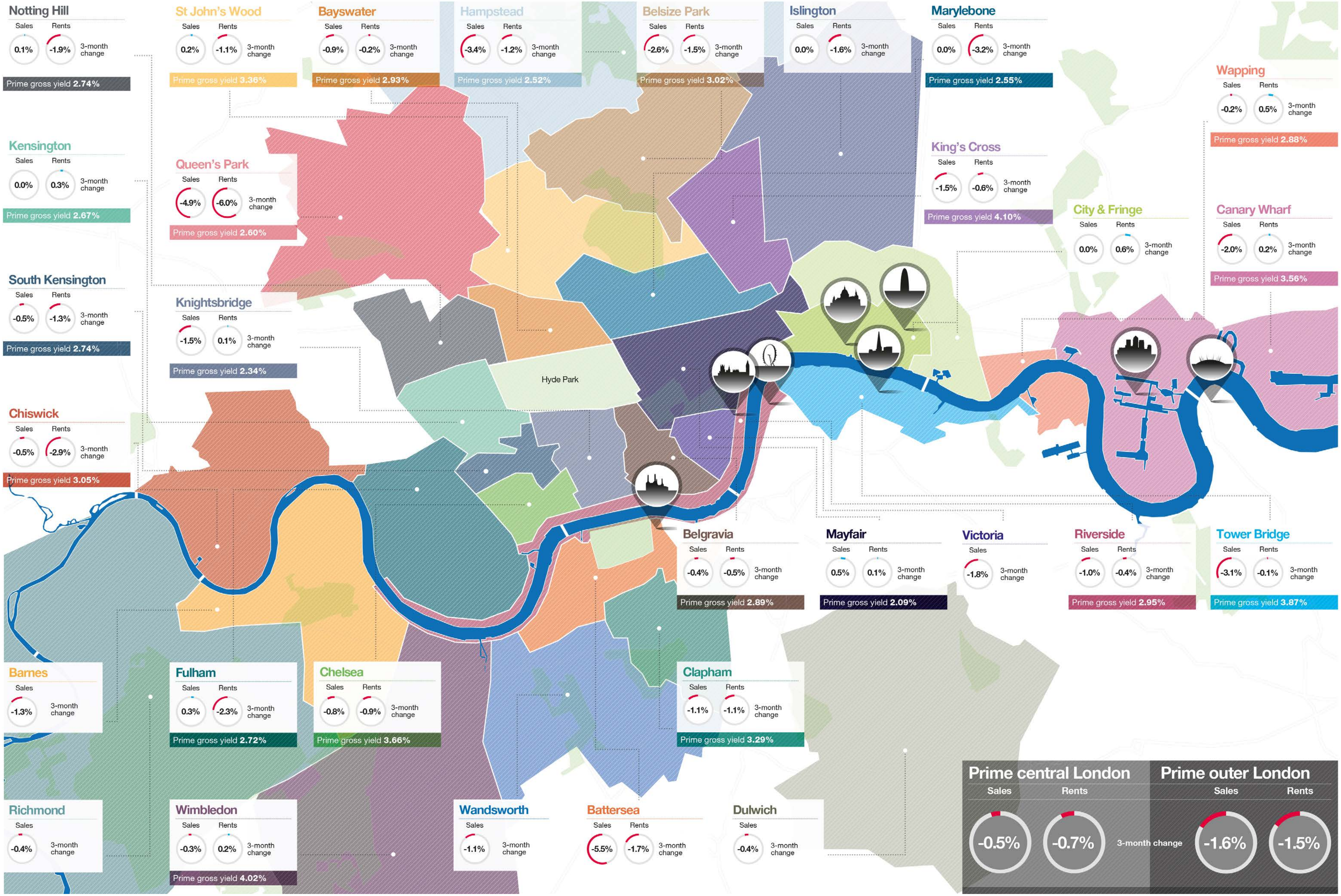
Source: Knight Frank Research

TOM BILL
Head of London Residential Research

"By the standards of the last four decades, pricing movements in the prime London property market have become less extreme."

Please refer to the important notice at the end of this report

PRIME LONDON PRICE AND RENTAL GROWTH, JANUARY 2018



3-month change

Area	Sales	Rents	Prime gross yield
Notting Hill	0.1%	-1.9%	2.74%
St John's Wood	0.2%	-1.1%	3.36%
Bayswater	-0.9%	-0.2%	2.93%
Hampstead	-3.4%	-1.2%	2.52%
Belsize Park	-2.6%	-1.5%	3.02%
Islington	0.0%	-1.6%	
Marylebone	0.0%	-3.2%	2.55%
Wapping	-0.2%	0.5%	2.88%
Kensington	0.0%	0.3%	2.67%
Queen's Park	-4.9%	-6.0%	2.60%
King's Cross	-1.5%	-0.6%	4.10%
City & Fringe	0.0%	0.6%	
Canary Wharf	-2.0%	0.2%	3.56%
South Kensington	-0.5%	-1.3%	2.74%
Knightsbridge	-1.5%	0.1%	2.34%
Chiswick	-0.5%	-2.9%	3.05%
Belgravia	-0.4%	-0.5%	2.89%
Mayfair	0.5%	0.1%	2.09%
Victoria	-1.8%		
Riverside	-1.0%	-0.4%	2.95%
Tower Bridge	-3.1%	-0.1%	3.87%
Barnes	-1.3%		
Fulham	0.3%	-2.3%	2.72%
Chelsea	-0.8%	-0.9%	3.66%
Clapham	-1.1%	-1.1%	3.29%
Richmond	-0.4%		
Wimbledon	-0.3%	0.2%	4.02%
Wandsworth	-1.1%		
Battersea	-5.5%	-1.7%	
Dulwich	-0.4%		

3-month change	Sales	Rents
Prime central London	-0.5%	-0.7%
Prime outer London	-1.6%	-1.5%

KEY FINDINGS

28
Consecutive months of quarterly rental value declines in prime central London

-19%
Decline in the number of properties listed for rent in Q4 2017 versus Q4 2016

17%
Rise in the number of new prospective tenants that registered in Q4 2017 versus Q4 2016 in PCL and POL

-0.6%
Average annual decline in rental values in PCL between £750 and £1,000 per week compared to -4.5% between £1,000 and £1,500 per week

PRIME LONDON LETTINGS MARKET INSIGHT

Supply levels have declined as more property owners sense the sales market bottoming out, says Tom Bill

The key feature of the prime London lettings market over the last several years has been the high level of supply versus the historical average.

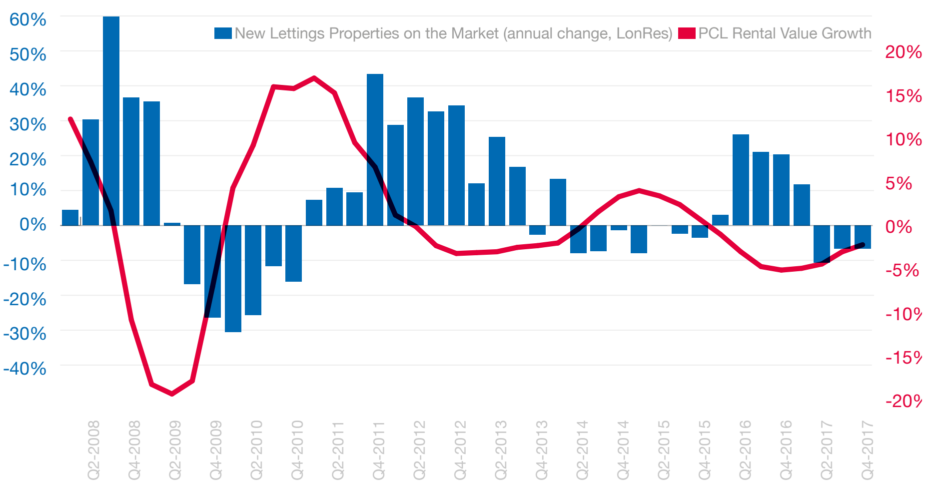
Uncertainty in the sales market pushed supply up as more property owners decided to let rather than sell. At the super-prime (£5,000-plus per week) end of the market, a record number of tenancies were agreed in 2017 and agents say a new breed of professional super-prime landlord has even been created, catering to tenants with demands as exacting as those of buyers.

Rental values fell as a result of higher stock levels. Indeed, rents fell on a quarterly basis in prime central London in January 2018 for the 28th consecutive month, setting a record for the last two decades.

However, as the chart below shows, the balance of power is starting to tip back in favour of landlords as levels of new supply moderate.

Indeed, the number of properties listed for rent in prime central London in the final three months of last year was 19% lower than the same period in 2016 and was the lowest quarterly figure since Q1 2015, Rightmove data shows.

FIGURE 1
Rental value declines moderate How declining stock levels can drive rental value growth



Source: Knight Frank Research / LonRes

In the super-prime lettings market, there is also anecdotal evidence that more tenants are putting a clause in their tenancy agreement to give them the first right of refusal to buy at the end of the tenancy in a so-called “try-before-you-buy” agreement.

As a result of tighter stock levels, the number of Knight Frank prime London markets reporting positive annual rental value growth in January 2018 was five compared to one in the same month last year.

They include Hampstead, where rents have risen by 1% over the last year. As well as less rental stock, there is also anecdotal evidence that a growing number of landlords in Hampstead are considering selling as price growth bottoms out. There are early signs of this trend across a number of London markets.

Other areas reporting positive rental value growth include King’s Cross, where supply is relatively constrained in a market with growing demand from students and tenants working in the tech sector.

Indeed, the importance of students in driving demand continues to grow. They represented 16% of all new prospective tenants in the year to January 2018, which was higher than a figure of 14% recorded in the preceding 12-month period and 11% registered in the year to January 2016.

Elsewhere, a series of new developments and public realm improvements in Mayfair have drawn tenants to the area, pushing up rental values by 4.8% in the year to January. The relative weakness of the pound has also made Mayfair more affordable to North American tenants, who are now more prevalent in the area.

By price band, annual rental value declines were less marked below £1,000 per week in PCL, a section of the market where demand has been stronger. There was an annual decline of -0.6% between £750 and £1,000 per week, which compared to -4.5% between £1,000 and £1,500 per week. Rental value growth between £1,000 and £5,000 has declined to a greater extent because of weaker demand among the traditional tenant base of senior executives due to economic and political uncertainty.

MACROVIEW RISING RATES AND BREXIT

The mood of complacency on global stock markets came to an end in February. The volatility on world markets showed investors are now factoring in rate rises in response to inflationary pressures across global economies.

In the UK, comparatively strong employment and wage growth data have bolstered the arguments of those who believe rates will rise more than once this year, with some economists pencilling in an initial rise in May.

The result is that the lending environment for residential property will become slightly less benign, which, for some buyers, could add to affordability pressures.

However, the same pressures may also bring about a degree of liquidity in some sections of the market over time. In particular, property owners whose mortgage repayments become more onerous may decide to sell.

Meanwhile, there has been little sense of complacency in the political arena in recent months. The key to anticipating the outcome of Brexit talks, as well as the likely impact on property markets, is understanding the compatibility of two unrelated processes.

The first is the negotiations between Brussels and London, which is focussed on the pragmatic matter of the post-Brexit relationship between the UK and the EU.

While the realpolitik is not always obvious, a direction of travel towards compromise is becoming more discernible, embodied by the UK government's apparent strategy of 'managed divergence' from EU rules in some areas.

The pound was trading 13% higher against the dollar at the start of February this year versus a year earlier, which captures the same sense of cautious expectation.

The key question, however, is how these official negotiations square with the views of a group of Conservative lawmakers pursuing their own version of Brexit.

From their perspective, the reward would be to obtain a cleaner break from the EU. The risk for them is that they topple the government as well as the Prime Minister and a new Labour government pursues a softer version of Brexit.

To fully understand the deliberations of this group of Brexit supporters, it is worth remembering that they differ on more than just their version of Brexit with the opposition Labour Party. They hold diametrically opposing views on many issues.

It is also fair to say that their precise vision for Brexit won't entirely mirror the views of the 52% of the UK population who voted to leave in June 2016.

It is likely that they will therefore consider carefully whether they have more to lose or gain by moving against the Prime Minister.

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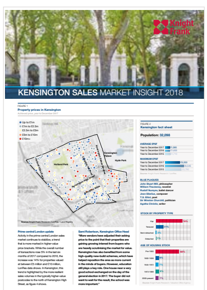
London Review Autumn 2017

Prime Central London Sales Index December 2017

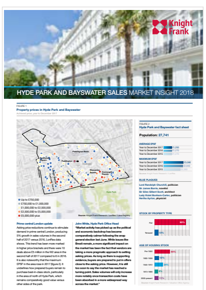
Prime Central London Rentals Index December 2017

Super-Prime Lettings Spring 2018

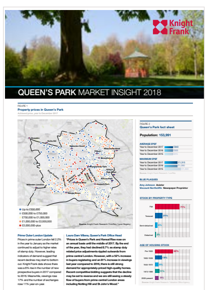
London Hotspots



Kensington market insight 2018



Hyde Park market insight 2018



Queen's Park market insight 2018